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Joint Adventure: Remedies Where A Corporation is Formed to Acquire Property of the Venture

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COMMENTS

JOINT ADVENTURE—REMEDIES WHERE A CORPORATION IS FORMED TO ACQUIRE PROPERTY OF THE VENTURE

A number of interesting questions have arisen in a recent Michigan case concerning the remedies of joint adventurers who form a corporation to purchase property.[1]

In 1937, plaintiffs, the Kowals, became interested in the Belcrest Apartments which was subject to mortgages amounting to more than a million dollars and had come under control of the bankruptcy court. Desiring to purchase this property from the trustee in bankruptcy, plaintiffs entered into an agreement with him for the purchase of the same for $347,500. The plaintiffs advanced the sum of $10,000 and sought a loan for the remainder from an insurance company. When it became apparent that funds would not be available, they sought the services of an attorney, Sang, who informed them that he had a client who would advance the required $347,500. A contract was entered into which required Sang's principal to invest the sum of $347,500 to be used for the acquisition of the property, and for the Kowals to invest the sum of $67,500 which included the $10,000 deposit which accompanied their bid to the trustee in bankruptcy. The contract provided that upon the acquisition of the property, a corporation was to be organized which would issue all of its capital stock to Sang in exchange for the property; that debentures would be issued to Sang and the Kowals in the amounts of their respective investments, with Sang's debentures to have priority in payment over the Kowals'. The plaintiffs acknowledged the fact that Sang was acting for an undisclosed principal, and agreed that no questions would be asked or no action brought with respect to the form of the debentures. The contract further provided that "the delivery to us of the debentures above referred to and of the stock to be issued is in full and complete payment and satisfaction of all our rights to the above premises or against you or any undisclosed principal represented by you."

Pursuant to the terms of the above contract, Sang paid the sum of $347,500 to the trustee in bankruptcy, and acquired the title to the Belcrest Apartments. Later the Sang Corporation was incorporated and Sang transferred his title to the corporation. Following the transfer of the property, Sang transferred 499 shares of stock to the Kowals and the remaining 501 shares to his principal. Debentures for $347,500 were issued to Sang's principle and debentures for $67,500 were issued to the Kowals.

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[1] Kowal v. Sang Corporation, 28 N.W. (2d) 113 (Mich., 1947).

In 1942, the Kowals sought to have this contract set aside on the ground that it did not represent the understanding and intention of the parties; that it was intended to operate as a mortgage on the hotel to secure the payment of $347,500; and that it was void because it was usurious and against public policy. The Michigan Supreme Court held that the money was advanced as an investment and not a loan, and that a joint-venture relationship existed between the parties; that the agreement in question represented the understanding and intention of the parties, and there was no evidence indicating that the Kowals were induced by fraud, trickery, or misrepresentation to sign the agreement, and it was not usurious, unfair, inequitable, unconscionable or against public policy.[2]

In 1945, the plaintiffs filed a bill for partition, alleging that they were co-owners in a joint adventure, and the formation of the corporation was merely a medium for carrying out the joint venture; and prayed for an accounting and a dissolution of the joint venture with a sale of the assets. The defendant, Sang Corporation, contended that the rights of the parties are to be determined by the contract; that the contract did not provide for the acquisition of real estate to be held by the parties as joint tenants or tenants in common, but merely provided for the investment and acquisition of property by one of the adventurers, its conveyance to a corporation to be organized, the issuance of all the capital stock to him; and that the agreement of the coadventurers was to reach its final consummation upon the distribution of the corporation's securities, and thereafter, these securities would be the fruits of the adventure.

The Michigan Supreme Court held the contract did not manifest an intention that the apartment building was to be held by the parties as tenants in common or as joint tenants; that the joint venture relation terminated when the parties received their stock in the new corporation; that the plaintiffs had mistaken their remedy, and on issuance of the stock, the plaintiff's rights were such rights as minority stockholders have in a corporation.

The legal concept of joint adventure is of modern origin, and has been said to be purely the creature of American courts.[3] A joint adventure has been broadly defined as an enterprise undertaken by several persons jointly; and more particularly, as an association of two or more persons to carry out a single business enterprise for profit, for which purpose they combine their property, money, effects, skill, or knowledge.[4] On the whole, however, the courts have not yet laid

[2] Kowal v. Sang, 312 Mich. 339, 20 N.W. (2d) 212 (1945).
[3] Bond v. O'Donnel, 205 Ia. 902, 218 N.W. 898 (1928); Crane Company v. Stopke, 65 S.D. 207, 272 N.W. 811 (1937.
[4] Fuller v. Laws, 219 Mo. App. 342, 271 S.W. 836 (1925); Boles v. Akers, 116 Okla. 266, 244 P. 182 (1925); Bond v. O'Donnel, supra, note 3.

down any very certain or satisfactory definition of a joint adventure, but in most cases, have been content to determine merely whether the facts in the particular case indicated the joint adventure relation. At common law, an enterprise of a limited character, such as is now called a joint adventure, was regarded in law as merely an informal kind of partnership, and the courts made no attempt to distinguish the one from the other.[5] However, the courts, about the middle of the last century, began to find it convenient to draw a distinction between them, and hence there is gradually developing a body of American law applicable to the relation of joint adventurers which may or may not apply to the relation of partners.[6] The divergence between the two relations is still very slight and is difficult of ascertainment in most circumstances. The outstanding difference of fact between a joint adventure and a partnership is that the former relates to a single transaction. Because of the limited scope of the relationship, it is generally more informal than the relationship between partners. There is some difference as to the availability of legal and equitable remedies as between the two relations. While legal remedies are not generally available to redress grievances between partners, they are more often available in controversies between joint adventurers, for instance where one sues his associates for breach of contract, or for a share of the profits or losses of the venture, and the sum due is agreed or otherwise clear.

It will be noted from the principal case that a joint adventure must have its origin in contract, and can exist only by the agreement of the parties to it. Whether the parties to a particular contract have created the relation of joint adventurers depends upon their actual intention, which is to be determined in accordance with the ordinary rules governing the interpretation and construction of contracts.[7]

Rights And Duties Of Joint Adventurers

Where a joint adventure is established, the law fixes the rights of the parties, and substantially the same principles that apply to a partnership govern the mutual rights and liabilities of joint adventurers in respect to their common enterprise. While it has been stated that it is necessary to estimate and define the mutual rights and obligations

[5] Lesser v. Smith, 115 Conn. 86, 160 A. 302 (1932); Neville v. D'Oench, 327 Mo. 34, 34 S.W. (2d) 491 (1930); Wertzberger v. McJunkin, 171 Okla. 528, 43 P. (2d) 729 (1935); Kaufman v. Catzen, 100 W.Va. 79, 130 S.E. 292 (1925).

[6] Pfingstl v. Solomon, 240 Ala. 58, 197 So. 12 (1940); Christian v. Baxter, 139 Kan. 381, 31 P. (2d) 21 (1934); Tufts v. Mann, 116 Cal. App. 170, 2 P. (2d) 500 (1931).

[7] Compagna v. Market St. Railway Co., 24 Cal. (2d) 304, 149 P. (2d) 281 (1944); Brown v. Wood, 293 Mich. 148, 291 N.W. 255 (1940); Edgerly v. Equitable Life Assurance Society, 287 Mass. 238, 191 N.E. 415 (1934); Krause v. Hall, 195 Wis. 565, 217 N. W. 290 (1928); Sanders v. Newman, 174 Wis. 321, 181 N.W. 822 (1921).

of joint adventurers in the light of the particular facts involved and the character of the undertaking, yet it is well settled that joint adventurers may agree to fix their rights as they choose, and it is this agreement which governs the relationship, rights, and duties of the parties.[8]

As in partnerships, joint adventurers owe one another the duty to observe the utmost good faith in all that relates to their common interest, from the beginning of negotiations for the formation of the association to its termination.[9] In the first *Kowal* case,[10] there was fair, open, and honest disclosure of everything affecting the relationship. It is apparent that in the absence of fraud or breach of good faith, there are no grounds for rescission of the contract by a disappointed member, except by mutual consent of the parties.

Remedies Of Joint Adventurers

As noted previously, legal remedies will more likely be available in controversies between joint adventurers than in controversies between partners. Where the case is simple and free from complexity, and damages are capable of being ascertained by a jury, the following remedies at law resulting in money judgments, have been made available to joint adventurers:

(1) *Breach of Contract*—One who has entered into a contract of joint adventure with another is bound to proceed with the enterprise until its termination. If either party, without just cause, abandons, repudiates, or substantially defaults in the performance of the agreement, the other party may terminate the relation and sue at law for the breach thereof.[11]

(2) *Fraud*—On discovery of fraud, he may rescind the contract and recover as damages the money contributed by him in the enter-

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[8] Hagerman v. Schulte, 349 Ill. 11, 181 N.E. 677 (1932); In re Week's Estate, 204 Wis. 178, 235 N.W. 448 (1931); Reinig v. Nelson, 199 Wis. 482, 227 N.W. 14 (1929); In re Taub, 4 F. (2d) 993 (C.C.A. N.Y., 1924).

[9] In Goldman v. Pryor, 172 Wis. 462 at 466, 179 N.W. 673 at 674 (1920), a leading Wisconsin case on bad faith of an adventurer in concealing secret profits, the Wisconsin Supreme Court, in commenting upon the duty of exercise of good faith, stated: "Where persons engage in a common enterprise by way of joint adventure, each has the right to demand and expect from his associates the utmost good faith, and is entitled to demand and expect fairness, honesty, integrity, and loyalty in all that relates to their common interests; within the scope of the enterprise, they stand in a fiduciary relation, each to the other, or in a close relationship of trust and confidence, and are bound by the same standards of good conduct and square dealing as are required between partners." See further Jones v. Kinney, 146 Wis. 130, 131 .W. 339 (1911); Knudson v. George, 157 Wis. 520, 147 N.W. 1003 (1914); Sicklesteel v. Edmonds, 158 Wis. 122, 147 N.W. 1024 (1914).

[10] Supra, note 2.

[11] Tompkins v. Commissioner of Internal Revenue, 97 F. (2d) 396 (C.C.A. 4th, 1938); Walker v. Leeming, 161 N.Y.S. 220, 174 App. Div. 395 (1917); Davidor v. Bradford, 129 Wis. 524, 109 N.W. 576 (1906); Crowley v. McCullough, 254 Mich. 362, 237 N.W. 50 (1928).

prise. The defrauded member, however, is not bound to rescind; he may, if he chooses to do so, retain his interest in the contract and recover damages for the fraud or deceit, the measure of damages being the difference between the amount actually paid to the plaintiff and the amount he would have been entitled to had the defendant dealt honestly with him.[12]

(3) *Negligence*—A joint adventurer owes to his associates the duty to exercise skill and care in the conduct of the business and will be held liable to them in damages for losses caused by his negligence, especially if his part in the adventure calls for the exercise of a particular or extraordinary degree of diligence and skill. However, he is not liable for losses which may be suffered through want of discretion or mistake of judgment.[13]

(4) *For Share of Profits*—An action at law to recover the share of profits of the venture, where a transaction under the venture has been closed, and the plaintiff's share has been or is ascertainable by simple computation.[14]

(5) *Failure to Share Losses*—For default in paying the proportionate share of losses, expenses ,or loans, an action may be brought to compel contribution, without also seeking a dissolution of the joint adventure.[15]

Irrespective of the above remedies available to the joint adventurer at law, the fiduciary relation which exists between the members confers equitable jurisdiction as to controversies arising between them. This jurisdiction will be exercised when the controversy is of a complex character and the remedy at law is therefore inadequate. The following equitable remedies have been recognized:

(1) *Dissolution*—Generally, equity will dissolve a joint adventure for causes which would justify the dissolution of a partnership. Thus, this remedy is available if a disagreement between the members is sufficiently serious to make the successful continuance of the venture

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[12] Fink v. Weisman, 129 Cal. App. 305, 18 P. (2d) 961 (1933); Menefee v. Oxnam, 42 Cal. App. 81, 183 P. 379 (1919); Allen v. Barhoff, 90 Conn. 183, 96 A. 928 (1916); Bigelow v. McMillin, 296 N.Y.S. 533, 251 App. Div. 456 (1937); Goldman v. Pryor, supra, note 9.

[13] Yanco v. Thon, 108 N.J. Law 235, 157 A. 101 (1930); Runkle v. Burrage, 202 Mass. 89, 88 N.E. 573 (1919); Knudson v. George supra, note 9.

[14] Elsbach v. Mulligan, 58 Cal. App. (2d) 354, 136 P. (2d) 651 (1943); Judson v. Buckley, 130 F. (2d) 174 (C.C.A. N.Y., 1942); Rhodes v. Little Falls Dairy Co., 230 App. Div. 571, 245 N.Y.S. 432 (1930); Mitchell v. Reolds Farms Co., 268 Mich. 301, 256 N.W. 445 (1934); Sanders v. Newman, supra, note 7.

[15] Wertzberger v. McJunkin, supra, note 5; Denny v. Guyton, 327 Mo. 1030, 40 S.W. (2d) 562 (1931); Hoffman v. Mittelmann, 147 Misc. 442, 263 N.Y.S. 899 (1933).

impracticable. Misconduct of the members is also a ground for dissolution but the misconduct must be more than petty or trivial.[16]

(2) *Accounting*—A suit for an accounting may be brought where profits or losses have not been ascertained, as where notes or other assets remain to be collected, or the situation is such that the amount to become due cannot be known until a full accounting has been had; or where a member refuses to account to his associate. In the absence of an agreement to the contrary, the right of action of a member for an accounting accrues on the completion or dissolution of the joint adventure. Because of the fiduciary relation of the parties, an accounting may be had where there has been fraud or a breach of the relationship, and the remedy at law for damages is inadequate. While the jurisdiction of equity may be invoked for an accounting where a single action at law will not suffice to terminate the entire controversy, the right of a joint adventurer to sue at law does not preclude a suit in equity for an accounting.[17]

(3) *Miscellaneous*—In a proper case, a suit may be brought to compel a sale of property and the distribution of the profits, where the agreement fixes the time of sale, and the property is not sold at or before the time fixed, or the agreement is silent as to the time of the sale, and the defendant arbitrarily refuses to make the sale;[18] or a decree may be sought for a conveyance of a proportionate interest in certain property by one party to the other.[19]

From this brief survey of legal and equitable remedies, it is apparent that none of them were available to the plaintiff in the principal case. In the first *Kowal* case,[20] the plaintiff failed to establish any of the above grounds for dissolution of the venture, and the Michigan Supreme Court stated in its opinion:

> "We find no evidence indicating that the Kowals were induced by fraud, trickery, or misrepresentation to sign the agreement. Under the facts and circumstances shown, we cannot say

[16] Green v. Kubik, 213 Ia. 763, 239 N.W. 589 (1933), where the court stated "in order to warrant a dissolution both parties to the joint adventure must enter into the quarreling and bickering"; Thompson v. Duncan, 111 Com. App. 44, 44 S.W. (2d) 904 (1933); Cull v. Cavanaugh, 95 Okla. 157, 218 P. 299 (1923); Eastman v. Axelbank, 246 App. Div. 842, 285 N.Y.S. 1 (1937).

[17] Chaffee v. Chaffee, 19 Wash. (2d) 607, 145 P. (2d) 244 (1943); Dunn. v. Stringer, 41 Cal. App. (2d) 638. 107 P. (2d) 411 (1940); Trounstine v. Bauer Pogue, and Co., 44 F. Supp. 767 (D.C. N.Y., 1942); Johanik v. Des Moines Drug Co., 17 N.W. (2d), (1945); McKibben v. Byers, 138 Kan. 216, 25 P. (2d) 357 (1933).

[18] Washington Pulp and Paper Corp. v. Robinson, 166 Wash. 210, 6 P. (2d) 632 (1932); Universal Sales Corp. v. Calif. Press Mfg. Co., 20 Cal. (2d) 751, 128 P. (2d) 665 (1942); Barry v. Kern, 184 Wis. 266, 199 N.W. 77 (1924).

[19] Mariana v. Summers, 269 App. Div. 840, 52 N.Y.S. (2d) 750 (1944); Watterson v. Knapp, 35 Cal. App. (2d) 283, 95 P. (2d) 154 (1937); Cull v. Cavanaugh, supra, note 16.

[20] Supra, note 2.

that it was usurious, unfair, inequitable, unconscionable or against public policy, as alleged."

Since the court concluded that the plaintiff mistook his remedy to be that of a joint adventurer, and held the venture terminated and his rights to be those of a minority stockholder in the corporation, the question arises as to the remedies available to a minority stockholder. It is clear that equity will not allow recovery in a stockholder's suit where the facts show no wrong to the corporation, or where the stockholder has himself sustained no injury; nor will equity interfere through the derivative or representative action of a stockholder in the internal affairs of a corporation managed by directors acting in good faith and within the limitations of their discretion.[21] In the recent case of *Prince v. Sonnesyn*,[22] the Minnesota Supreme Court set aside the incorporation of a partnership and the distribution of stock where it was found that the plaintiffs were induced by fraudulent representations to convert their partnership into a corporation. In the principal case, the Kowals' remedies are against the corporation, or the other stockholders on the ground of fraud. If fraud is established, then under the doctrine of the *Prince* case, the incorporation and distribution of the stock and debentures may be rescinded and set aside and the parties will resume the status of joint adventurers. It is evident, however, that in the absence of proof of fraud, mismanagement, misappropriation or waste of corporate funds or assets, diversion of funds, ultra vires acts, or other breach of trust, the plaintiff will have no rights as a minority stockholder.

The *Kowal* case thus illustrates that the right of coadventurers in the enterprise depends primarily upon the agreement under which the parties are operating. A clear and concisely drawn contract determining the rights of the parties is always the best insurance against subsequent misunderstanding and loss.

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[21] Bissel v. Taylor, 229 App. Div. 369, 241 N.Y.S. 717 (1930); Miller v. Youmans Burke Oil & Gas Co., 278 Mich. 647, 270 N.W. 819 (1937); Johnson v. King-Richardson Co., 36 F. (2d) 675 (C.C.A., Mass., 1930); Babcock v. Farewell, 245 Ill. 14, 91 N.E. 683 (1910); Wolfes v. Paragon Refining Co., 74 F. (2d) 193 (C.C.A., Ohio, 1935).

[22] 25 N.W. (2d) 468 (1947); as to the power of equity to set aside the incorporation of a partnership on the ground of fraud, see 31 Marq. L. Rev. 182 (1947).